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LAW OR ECONOMICS?*

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When Aaron Director and Edward Levi launched the *Journal of Law and Economics* in 1958, Director suggested the title *Law or Economics*. This alternative title certainly described the world more accurately at that time: the traditional attitude of each discipline toward the other had been one of indifference. Only gradually has that attitude been replaced by a mixture of cooperation and hostility.

The first systematic application in America of economics to law was the use of price theory to explain economic phenomena involved in the antitrust cases.[1] Director made creative use of price theory to explain phenomena such as tie-in sales and patent licensing and assisted younger colleagues such as John McGee and Lester Telser in their respective studies of predatory competition and resale price maintenance.

In such applications, professional economic analysis was replacing the amateur economics of the lawyer. Lawyers did not welcome this development: the National Committee for the Study of the Antitrust Laws was the scene of a deep schism between the fifty-three lawyers and the eight economists.[2] (These numbers probably represented the belief that 13 percent of antitrust policy is economics, the remainder law.) At one point, the lawyers attempted to exclude the economists completely from the formulation of the report.

The division was not simply one between angels and legally trained devils. Consider the question of price discrimination. Economists insisted that price discrimination could persist only under noncompetitive conditions: under full competition, rivals would undermine any attempt to sell part of the supply at a higher price. The lawyers argued to the contrary:

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[1] I put aside earlier and very different work on the two disciplines by Richard Ely and J. R. Commons.

[2] U.S. Department of Justice, Attorney General's National Committee to Study the Antitrust Laws, Report (1955).

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only by price discrimination—emerging from the bargaining for preferential prices—could a collusive price be undermined by aggressive sellers or strong buyers.

In retrospect, both parties were partially right and partially wrong. Persistent, stable price discrimination is conclusive evidence of a noncompetitive market, but that is a long-run equilibrium condition. The economists had no short-run or dynamic theory of the process of market-price determination. It required theories, then unavailable, of auctions and information to begin a proper reconciliation of the two views.

Director's reliance on price theory to explain market behavior marked a departure from not only the traditional legal treatment of monopoly and competition but also the prevailing industrial organization literature of the economists. The economic writings in the earlier muckraking period and in the period following Gardiner Means's influential studies were most economical in their use of economic theory.[3] The "theory" of price rigidity, for example, was primarily an assertion of an empirical fact, not a practice explicable by ordinary profit-maximizing theory. (The kinked oligopoly demand curve was an implausible theoretical exception to this generalization.)[4] In current language, price rigidity would be called a stylized fact.

I. B.C. AND A.C.

In the field of law and/or economics, B.C. means Before Coase. B.C., the economists paid little attention to most branches of law. A.C., "The Problem of Social Cost" became the most cited article in the literature of the field, perhaps in the entire literature of economics.[5] Law, like other social institutions, came to be viewed by economists as an instrument for the organization of social life. Coase reminded economists and taught lawyers that, in a world of exchange by agreement rather than by coercion, the costs and benefits of agreement determine its scope. Because agreements can be costly, many will not be struck, and these unachieved agreements will have been inhibited by the smallness of the benefits or the largeness of the costs of agreement.

Agreements are the central domain of noncriminal exchange, so sud-

[3] Gardiner C. Means, Industrial Prices and Their Relative Inflexibility (U.S. Senate Document 13, 74th Congress, 1st session, January 17, 1935); and Gardiner C. Means, The Administered-Price Thesis Reconfirmed, 62 Am. Econ. Rev. 292 (1972).

[4] Paul M. Sweezy, Demand under Conditions of Oligopoly, 47 J. Pol. Econ. 568 (1939); George J. Stigler, The Kinky Oligopoly Demand Curve and Rigid Prices, 55 J. Pol. Econ. 432 (1947); George J. Stigler, The Literature of Economics: The Case of the Kinked Oligopoly Demand Curve, 16 Econ. Inquiry 185 (1978).

[5] R. H. Coase, The Problem of Social Cost, 3 J. Law & Econ. 1 (1960).

denly the economist had a voice in the study of contracts, property, torts, and other branches of law. A subject such as corporate organization that previously had been heavily oriented toward fiducial responsibility and fairness now became—in the hands of Armen Alchian and Harold Demsetz, Henry Manne, Oliver Williamson, Michael Jensen and William Meckling, and others—a subject in the economics of principal and agent.[6]

At roughly the same time as Coase's article, Anthony Downs and James Buchanan and Gordon Tullock were initiating the application of economics to political phenomena.[7] The existence and nature of public regulation of economic life became subjects for study, not simply exogenous forces to which the economic system responded. There is a certain affinity between the two movements of law and economics and the new "political economy," although their leaders were working independently.

The Coase Theorem says, at a first pass, "forget about the law: look at costs and benefits to see how economic life is conducted." The law has an influence on exchange (to which we shall soon turn), but it has a supporting role, not the lead.

Does Coase's proposition require proof? One would think not. It is similar to a proposition in international trade: the prices of internationally traded goods in two national markets will differ by no more than the cost of moving the goods between the markets. Suppose I started to test the proposition and found that the prices of some good in England and America differed by more than the costs of movement. I would immediately abandon the test and embark on lucrative arbitrage transactions. Similarly, if I found that Coase's famous grain farmer and cattle rancher were making foolish decisions with respect to the damage to grain from wandering cattle, I would buy the two enterprises and reap a capital gain from an efficient reorganization.

That cannot be the entire story, however: human behavior is not as rigorously deterministic as a multiplication table. There are some people who do not care for wealth, more who do not reason well, and vastly more who are incompletely informed. These people will not necessarily achieve optimal agreements, and this is specially true in new and unfamiliar circumstances. We do not believe that such people govern important

[6] See Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 Am. Econ. Rev. 777 (1972); Henry Manne, Mergers and the Market for Corporate Control, 73 J. Pol. Econ. 110 (1965); Oliver E. Williamson, The Economics of Discretionary Behavior: Managerial Objectives in a Theory of the Firm (1964); and Michael C. Jensen & William H. Meckling, The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976).

[7] Anthony Downs, An Economic Theory of Democracy (1957); James M. Buchanan & Gordon Tullock, The Calculus of Consent (1962).

markets: other market participants who love wealth, reason precisely, and buy information in optimal quantities will call the tune. So one set of empirical studies could be directed to the determination of the efficiency of small (thin) markets, with special attention to short-run reactions to altered circumstances (shocks). Examples of such situations are the reactions of wages of highly specialized people to large, unpredicted changes in the demand for their services and the structure of prices in markets too small to support specialists.

A second and much more interesting and important set of studies could be directed to the costs of achieving agreements (transaction costs). In fact, such studies have been undertaken by Demsetz, Williamson, and many others, and much attention has been lavished on the security markets.[8] But neither this set of studies nor those of inefficient markets is directed to the logic of the Coase Theorem; instead, they are directed to its domain. This is not to minimize the desirability of the studies—after all, it is a theory's domain of applicability that determines its importance to a science.

And so economics invaded the whole domain of law. Even involuntary transactions, chiefly crime, were brought in under Gary Becker's leadership.[9] Eventually, every prominent law school had an economist, although it is my impression that the economist was outside the school's main intellectual life. Economics is not especially difficult to study, so an increasing number of lawyers attained a higher level of economic sophistication.

II. Efficient Law

We, or at least I, mean by maximum efficiency that a given goal is achieved as best as one knows how. The concept of efficiency contains two values: a valuable goal and valuable means (inputs) with which to achieve that goal. Maximum efficiency consists of achieving a maximum value of output from a given value of inputs.

The economist's conventional concept of efficiency turns on the maximization of the output of an economic process or of an economy. There is no reason to quarrel with this definition, and it has produced a widely used system of welfare economics. That definition, however, accepts private market judgments on the values of goods and services, and, in

[8] Harold Demsetz, The Cost of Contracting, 82 Q. J. Econ. 33 (1968); and Oliver E. Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J. Law & Econ. 223 (1979).

[9] See, for example, Gary S. Becker, Crime and Punishment: An Economic Approach, 76 J. Pol. Econ. 169 (1968).

policy analysis, one may legitimately employ an alternative definition of efficiency that rests on the goals adopted by the society through its government. When a society wishes, for example, to give more income to a group than the market provides, we may surely analyze the efficiency with which this is done.

In this latter view, every durable social institution or practice is efficient, or it would not persist over time. New and experimental institutions or practices will rise to challenge the existing systems. Often the new challenges will prove to be inefficient or even counterproductive, but occasionally they will succeed in replacing the older system. Tested institutions and practices found wanting will not survive in a world of rational people. To believe the opposite is to assume that the goals are not desirable: who would defend a costly practice that produces nothing?

So I would argue that all durable social institutions, including common and statute laws, must be efficient. Here I depart from the theory developed by Richard Posner that the common law (but not always statute law) seeks economic efficiency.[10] I shall argue that efficiency is to be judged only with respect to the goals one seeks.

Consider the following example. The United States wastes (in ordinary language) perhaps $3 billion per year producing sugar and sugar substitutes at a price two to three times the cost of importing the sugar. Yet that is the tested way in which the domestic sugar-beet, cane, and high-fructose-corn producers can increase their incomes by perhaps a quarter of the $3 billion—the other three quarters being deadweight loss. The deadweight loss is the margin by which the domestic costs of sugar production exceed import prices. Lacking a cheaper way of achieving this domestic subsidy, our sugar program is efficient. This program is more than fifty years old—it has met the test of time.

The Posnerian theory would say that the sugar program is grotesquely inefficient because it fails to maximize national income. Maximum national income, however, is not the only goal of our nation, as judged by the policies adopted by our government—and government's goals as revealed by actual practice are more authoritative than those pronounced by professors of law or economics.

The Posnerian logic takes a different path. Common law, he and William Landes argue, is unsuited to the redistribution of income:

> Tort law, we suggest, is a public good. This is all the more plausible because it deals with activities (mainly accidents) that do not lend themselves well to redistribution in favor of politically influential groups. The probability of being

[10] Richard A. Posner, Economic Analysis of Law (3d ed. 1986).

> involved in an accident, either as victim or injurer, does not vary in a regular or consistent manner across the compact and readily identifiable interest groups that bulk so large as recipients of government largesse in the redistributive theories of government. . . . When systematic redistribution is difficult to achieve, an interest group's best strategy is to support policies that will increase the wealth of the society as a whole, because the members of the group can be expected to share in that increase.[11]

This argument, it should be noted, is fundamentally empirical: it is difficult for Landes and Posner to think of doctrines of common law, especially on torts, that could be used to benefit an important political group. That statement has no direct support, and its indirect support has taken the form of finding productive-efficiency explanations for the changing content of tort law. Thus, in a brilliant essay on railroad-accident law, Posner found an income-maximizing explanation for the various changes in relevant tort law.[12] I find that line of proof unconvincing—only time is needed for a highly intelligent person to produce a possible explanation in terms of transaction cost for most of the legal doctrines chosen for examination.

It is methodologically unsound to test Posner's efficiency hypothesis by examining court cases. A desirable business practice may be foreclosed simply because the common law does not allow or overburdens the practice—this would never be discovered by examining court cases. An efficient practice excluded by the common law may find ways or places in which to circumvent or escape the law. The Posnerian test starts at the end—litigation—instead of at the beginning—the universe of business practices that would be pursued in the absence of legal obstacles.

My counterargument proposes that ruling political groups produce and retain the doctrines of common law that serve them best. In an important sense, the Posnerian school already admits this: they point out that a politically effective group resorts to statute law when it is dissatisfied with the common law.[13] This is surely equivalent to saying that, when the common law is left alone, it is because it serves the politically effective group without statutory modification or because it lacks an influential opponent.[14]

[11] William M. Landes & Richard A. Posner, The Economic Structure of Tort Law 15–16 (1987).

[12] Richard A. Posner, A Theory of Negligence, 1 J. Legal Stud. 29 (1972).

[13] Landes & Posner, *supra* note 11, at 219–22.

[14] Landes and Posner do not recognize the existence of this alternative hypothesis: "no rival positive economic theory of tort law has been proposed." *Id.* at 1 and 21.

Finally, what is the distinction between common law and statute law? Common law is the accumulation of decisions made in response to actual litigation and the evolving circumstances that the cases present to the courts. But this is also the nature of statute law: the Sherman Act today is the cumulation of one hundred years of judicial decisions, influenced as well by actual cases and the changing economic, legal, and political circumstances of that century. The actual statute of 1890 and its legislative amendments are an extremely small part of the effective content of the law today. How can so minor a distinction between common and statute law underlie such a radical difference in their workings?

And yet there is an element of important validity in Posner's thesis. A redistributive political or legal act usually confers its benefit at the time of enactment. Hence, any instrument of policy that allows only gradual or infrequent change in policy must be used relatively infrequently to achieve income redistribution. The common law may have become a more suitable instrument for income redistribution in this age of judicial activism, but it is less suitable for most political redistribution than statutory or administrative law.[15]

III. Efficiency or Justice?

Let us ask economists to address an old question in antitrust policy: what are the proper areas in which to apply per se rules, and where should we apply the so-called rules of reason that take account of the particular facts of a challenged industrial practice? So far as I know, the answers hitherto given by economists (like the answers of the lawyers) have been based only on general observation and attention to individual cases. How would they proceed to answer the question if it were presented as a scientific challenge?

The economist would seek to establish the relative efficiencies of the two methods of dealing with a set of potential antitrust violations. Efficiency would place emphasis on the deterrence offered by the two methods of enforcement. Deterrence would itself be a ferociously difficult problem in empirical research because we wish to deter all violations of the antitrust laws, not only detected violations. Efficiency would attend to the costs of enforcement and the costs of defense of challenged busi-

[15] The political influence on the common law must come from the selection of judges and the potential statutory revisions of the law by legislatures. The tenure of judges is long, and their turnover slow. The literature on the alleged influence of business on tort law errs in ignoring the long lag one expects between changing political climate and judicial interpretation. This also presents a problem in testing the quasi-Marxist interpretation of tort law and the responses to it. See G. T. Schwartz, Tort Law and the Economy in Nineteenth-Century America: A Reinterpretation, 90 Yale L. J. 1717 (1981).

nesses. Efficiency would give weight also to the degree to which the two rules of enforcement interfered with or prevented economically desirable business practices.

Even to make crudely useful estimates of these elements would be a most formidable challenge to economists. Ease of solution, however, is not the best guide in the selection of agenda for scientific research. I would be prepared to exchange the next twenty articles on game theory in industrial organization for a major attack on the comparative efficiencies of per se and rule-of-reason policies. My intuition is that the rewards to a successful attack on the problem would be larger for economics than for the policy of antitrust.

If efficiency is the fundamental problem of economists, justice is the guiding beacon of law professors. Consider a discussion of this very question of per se and rule of reason in antitrust policy by Justice Antonin Scalia. Justice Scalia was a professor of law at the University of Chicago Law School and is familiar with economics as onetime editor of *Regulation,* so one expects his views to represent the most intelligent and learned as well as an authoritative pole of legal academia. Needless to say, Justice Scalia touches on many facets of the problem of rules versus attention to the circumstances of a case—if brevity is the soul of wit, it is also the implacable enemy of legal writing. Scalia places much weight on "the appearance of equal treatment." "The Equal Protection Clause," he states, "epitomizes justice more than any other provision of the Constitution."[16] He touches on many points in the essay—including values such as predictability that are also relevant to this discussion of efficiency. But the bedrock on which the verdict for rules rests is justice. Justice Scalia believes in justice.

Now, I do not want to argue that economists believe in injustice, as popular as that argument would make me in some circles. Indeed, I must freely admit that one large and popular branch of economics—welfare economics—is saturated with talk of fairness—the poor man's word for justice—and there is even a growing literature on the economic theory of fairness. Welfare economics, however, is similar to positive economics only in method: it replaces the standard goal of utility-maximizing behavior with some ad hoc ethical rule such as John Rawls's maximin postulate.[17] Economic analysis designed to defend an ethical position—a striking example is the literature on progressive income taxation—has usually served only to show that economists strive to support generally

[16] Antonin Scalia, The Rule of Law as a Law of Rule, 56 U. Chi. L. Rev. 1178 (1989).

[17] John Rawls, A Theory of Justice (1971).

accepted ethical views with an ad hoc economic foundation. But rationalizations are not foundations.

The difference between a discipline that seeks to explain economic life (and, indeed, all rational behavior) and a discipline that seeks to achieve justice in regulating all aspects of human behavior is profound. This difference means that, basically, the economist and the lawyer live in different worlds and speak different languages.

IV. Prosperity or Depression?

I turn now to examine the extent of the penetration of economics into law. At the outset, one must recognize that economics has always been part of every legal system, as it must be of all rational behavior. No judge requires impossibly expensive proof, or denies that more will be bought at a lower price, or imposes unendurable penalties. Jurors will be excused if their presence in the courthouse would be immensely burdensome.

Moreover, the elements of economic reasoning do not necessarily become more rigorous or valid simply by being stated in the words and symbols of a trained economist: an extremely formal economic essay can be vapid; a simple verbal argument can be illuminating. To measure the role of economics in legal scholarship or litigation would require a painstaking study of the appropriate literature and would probably yield seriously imprecise estimates.

It may be useful to make a slight beginning to the task. Do the major law journals contain any important amount of professional economic analysis? (One measures professional analysis by explicit formal economic content or substantial references to economic literature.) Legal writing that makes extensive use of economic analysis can, of course, be published elsewhere, but that would reveal a less-complete integration of economics into legal scholarship.[18] We must also recognize that there are lawyers with sophisticated knowledge of economics even though they have no advanced degree in economics (but one suspects that economists would count fewer such lawyers than the lawyers do).

Consider a census of who is writing in major law journals (Table 1). The sample is narrow, but it contains two schools where economics received an early and warm reception. It is quite evident that these law journals are not a significant outlet for writing by economists. In the most recent period (1985–88), of 208 contributions, four were by economists, and two were by lawyers with advanced economic degrees; the propor-

[18] To the extent that economists or law professors publish in economic journals, the same distancing is displayed.

TABLE 1

AUTHORS OF MAJOR ARTICLES IN LAW JOURNALS

	LAWYERS		NONLAWYERS		
PERIOD	Professors	Others	Economists	Others	TOTAL
A. *Harvard Law Review:*					
1965/66–1967/68	45	24	2	5*	76
1975/76–1977/78	45†	6	2	3	56
1985/86–1987/88	54‡	25	2	1	82
B. *University of Chicago Law Review:*					
1965/66–1967/68	29	6	1	5	41
1975/76–1977/78	31	4	1	4	40
1985–87	56	4	1	2	63
C. *Yale Law Journal:*					
1965/66–1967/68	36	16§	11	5	68
1975/76–1977/78	40‡	19	2	9	70
1985/86–1987/88	50‡	6	1	6	63

NOTE.—Coauthors are given full weight.
* Includes participants in a symposium on law and social science.
† Includes two law professors at law schools with Ph.D.s in economics.
‡ Includes one law professor with a Ph.D. in economics.
§ Includes one law student with a Ph.D. in economics.

tion was higher a decade before. In fact, the main writings on the law by economists have appeared in professional economic journals and journals such as this one and the *Journal of Legal Studies*. Even in these latter journals, the chief contributors are not associated with law schools (see Table 2): most writing on law and economics comes from areas outside law schools. In the most recent period, 26 of 215 articles were written by noneconomist members of law faculties.

There has been an extensive interest by lawyers in economic elements of antitrust policy that long preceded the law-and-economics movement, so one cannot look here for the growth of economic analysis in law. To determine the effect of the law-and-economics movement on other legal writing, I examined the role of economics in articles and notes devoted to torts and contracts (Table 3). These are fields that invite economic analysis in the post-Coasean world. Table 3 suggests that the invitation is accepted roughly one-third of the time under a generous standard in judging economic content. The numbers are too small to reveal any trend, but there appears to be only a moderate effect of economics in these areas, even when one requires only a modest attention to economics to qualify.

These slender tabulations cannot yield a clear picture of the role of economics in contemporary legal scholarship. Casual observation sug-

TABLE 2

AUTHORS OF ARTICLES IN LAW AND ECONOMICS JOURNALS

Author	*Journal of Law and Economics*	*Journal of Legal Studies*	*Journal of Law, Economics, and Organization*	Total	Total by Percent
A. 1972–75:					
Noneconomic law faculty	8	21	. . .	29	19
Economic Ph.D. law faculty	5	7	. . .	12	8
Nonlaw faculty	77	36	. . .	113	73
Total	90	64		154	100
B. 1985–88:					
Noneconomic law faculty	0	17	9	26	12
Economic Ph.D. law faculty	4	23	13	40	19
Nonlaw faculty	73	34	42	149	69
Total	77	74	64	215	100

SOURCE.—Robert C. Ellickson, Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics, 65 Chicago-Kent Law Review 33 (1989).

NOTE.—Articles were not counted if they appeared in special (odd-date) issues or were brief responses to articles appearing in the same issue. In the case of coauthors, when at least one coauthor had a full law-school title, the article was treated as a law-faculty article; when at least one coauthor had an economics Ph.D., the article was counted as an economic-Ph.D. article.

TABLE 3

ECONOMIC CONTENT OF ARTICLES AND NOTES ON TORTS AND CONTRACTS

Period	Number of Articles and Notes	Economic Content		
		None	Some	Professional
A. *Harvard Law Review:*				
1964/65–1966/67	5	4	1	0
1974/75–1977/78	6	5	1	0
1984/85–1986/87	4	2	2	0
B. *University of Chicago Law Review:*				
1966/67–1967/68	5	4	1	0
1975/76–1978/79	4	2	2	0
1986–87	8	4	3	1
C. *Yale Law Journal:*				
1966/67	5	2	2	1
1976/77–1977/78	6	5	1	0
1986/87	5	4	1	0

NOTE.—Where there were fewer than five articles on torts and contracts in the years 1966/67, 1976/77, and 1986/87, the period was extended up to a maximum of four years. Jerry Marschke and Claire Friedland were responsible for determining economic content.

gests that economists participate in several courses on subjects such as antitrust law and capital markets but play a limited role in the central curriculum.[19] One piece of evidence for this conclusion is financial: it is my impression that much of the financial support for law-and-economics programs comes from a few foundations, with only small support from the regular law-school budget.

V. CONCLUSION

No discipline welcomes a broad-scale invasion by an alien and complex body of doctrine and method. Most economists stubbornly ignored mathematics from the 1890s until almost World War II. The invasion of history by cliometrics appears to the outsider to have had no warmer a reception.

Once this natural reaction is taken into account, the width of the foothold that economics has obtained in law schools is impressive. Most major law schools have one tenured economist, and some have two. This degree of acceptance is a tribute to the labors of Coase and Posner and their gifted colleagues.

Economics has two fundamentally different roles that it might play in law. The first role is simply to provide its expertise on points requested

[19] A slightly larger role is given to economics by E. Gellhorn & G. O. Robinson, The Role of Economic Analysis in Legal Education, 33 J. Legal Educ. 247 (1983).

by the lawyers. If lawyers want to address the size of a market in an antitrust case, or the consequences of preventing takeover bids, or the nature of dumping in international trade, they will employ economists. No one else in the community can be as exact and as comprehensive in analyzing the phenomenon. Of course, the adversarial process will allow a variable amount of ambiguity to be introduced, but that is probably a net benefit.

A second, more controversial role for economics is in the study of legal institutions and doctrines. Consider a possibly simple example: the transfer of titles to real estate. One can ask why the Torrens system of transferring land titles is adopted in some places but not in others, what the full costs of the various methods of transferring titles are, and who bears them. The answers to these questions are not exclusively legal and economic—indeed, they obviously involve the workings of the political system. Understanding the source, structure, and evolution of a legal system is the kind of project that requires skills that are possessed but not monopolized by economists, for it is in good part an empirical project addressed to rational social policy. Such studies are not necessary and are possibly even disruptive in a discipline whose fundamental task is to train practitioners. If they become acceptable to law faculties, the economist in the law school will become a full partner in a fundamental enterprise.

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